DEVELOPMENT (1947) Department

SERIES.

G.O. No. 5597

Dated 3-12-1947

[Despatch Abstract.]

Co-operative societies - Land Mortgage Banks - Guarantee of debentures by Government - Continuance - Orders passed.

Development Department

Memorandum No.97849 B/46-1, dated 19th Dec. 1946.

Subject: CO-OPERATIVE SOCIETIES - Land Mortgage Banks - Central Land Mortgage Bank, Madras - Guarantee of debentures by Government - future policy.

The Government desire that the question of the future policy of the Government in regard to guaranteeing the debentures issued by the Central Land Mortgage Bank should be examined now. It has always been the intention of Government that this guarantee system should be terminated as soon as a stage is reached when the Central Land Mortgage Bank is able to stabilise its business. But an abrupt withdrawal of the guarantee may have serious repercussions on the future of the Bank and it may not be able to raise money as cheaply as it is now doing or there may be other difficulties in the way of the Bank floating its debentures successfully in the open market. Any decision as to future policy in this regard should, therefore, be taken after a full examination of its implications. Even the Reserve Bank which has consistently advocated the ending of the guarantee contemplates the drawing up of a scheme for divesting the Government of their obligations under the guarantee over a period of years.

The attention of the Registrar, is also invited in this connection to the letters of the Reserve Bank, No.C.O.259/16-4, dated 9-10-1941 and No.A CD-1274/AC.122-42, dated 18-7-1942 communicated to him with Government endorsements No.26338-B/41-1, dated 29-10-1941 and No.19135-B/42-1, dated 27-8-1942 respectively. The Registrar, is requested to examine the question carefully and submit a report to Government.

Sd. x x x x
18-12-1946.

To
The Registrar of Co- operative Societies, Madras.

/TRUE COPY/

CO-OPERATIVE DEPARTMENT

From
Sri Rao Bahadur J.C.Ryan, M.A.,
Registrar of Co-op. Societies,
Chepauk, Madras.

To
The Secretary to Government,
Development Department,
Fort St. George, Madras.

No. Rd.20579/46-J, dated 28-9-1947.

Sir,

Sub: CENTRAL LAND MORTGAGE BANK - Guarantee of debentures by Government - Future Policy.

Ref: Development Memo No.97849-B/46-1, dated 19-12-1946.

In the Memorandum cited above, Government have desired that their policy in regard to guaranteeing the debentures issued by the Central Land Mortgage Bank should be examined. At present, Government have guaranteed the debentures issued by the Central Land Mortgage Bank in respect of principal and interest to the extent of Rs.400/- lakhs. Vide G.O.No.3659, Development, dated 11-10-1946. The question is not whether Government should withdraw the guarantee already given but whether they should continue to guarantee the debentures issued hereafter.

2. INVESTMENTS AND LOANS ON DEBENTURES WILL SUFFER:- As Govt. have observed in the memorandum under reply an "abrupt withdrawal of the guarantee may have serious repercussions on the future of the bank and it may not be able to raise money as cheaply as it is now doing, or there may be other difficulties in the way of the Bank floating its debentures successfully in the open market" I detail below the dangers that might result if the Government guarantee is withdrawn:--

(i) The debentures that are issued without Government guarantee may not be purchased by the public. On 30-6-1947 those who had invested in the Central Land Mortgage Bank debentures which are guaranteed by Government were as follows:

Investors.	Amount in lakhs.	Percentage
Individuals.	24	6.8
Joint Stock & Insurance Companies	81	23.1
Local Bodies	86	24.5
Co-operative Institutions	143	40.7
Trust Funds	8	2.3
Others	9	2.6
	351	100.

From the above figures, it will be observed that the most numerous holders of Central Land Mortgage Bank debentures are Joint-stock and Insurance Companies, Local Bodies and Co-operative Institutions. They have invested in these securities because they are Trustee Securities under Section 20 of the Indian Trust Act of 1882. Under Section 27 of the Insurance Act of 1938, Insurance Companies can invest their funds in Trustee Securities. Under Section 34(a) of the Madras Co-operative Societies Act, co-operative societies can invest their funds in Trustee Securities. Under Section 277 K (3) of the Indian Companies Act, 1913, Joint-stock companies can invest their funds in Trustee Securities. [*] Under Section 20 of the Indian Trust Act itself, trust funds as such can be invested only in Trustee Securities. If Government withdraw their guarantee of principal and interest given to the Central Land Mortgage Bank debentures, these debentures cease to be Trustee Securities and these institutions cannot purchase them. In other words, over 90% of those who invest on the Central Land Mortgage Bank debentures will be lost when Government stop guaranteeing them, and the market for them will therefore vanish.

[*] Under Rule 8 of Schedule V of the Madras Local Board's Act XIV of 1920 and G.O. 219 L&M, d/17-1-'33 the local bodies have to invest their surpluses in Trustee Securities.

(ii) The Reserve Bank will not lend on the security of the Central Land Mortgage Bank debentures if Government guarantee is withdrawn. Under Section 17(4) (a) of the Reserve Bank of India Act (1934), the Reserve Bank of India can make loans and advances on the security of the Central Land Mortgage Bank debentures only because under Section 20 of the Indian Trust Act the Central Land Mortgage Bank debentures are Trustee Securities. If Government guarantee is withdrawn, the debentures cease to be Trustee Securities. In their recent letter No.A.C.D.1489/Ac.144/47 dated 23-8-47, the Reserve Bank of India have said that they are agreeable to consider favourably the granting of accommodation against Central Land Mortgage Bank debentures up to 80% of their market value in an emergency. Although no loans have yet been given on the security of these debentures the opportunities for raising loans on these debentures will be lost if the debentures are deprived of Government guarantee.

3. RECOMMENDATIONS OF CONFERENCES AND COMMITTEES: It is in consideration of the dangers indicated in the foregoing paragraph that several conferences and Committees expressed themselves against the discontinuance of Government guarantee for Central Land Mortgage Bank debentures. I extract below the opinions of some of them:

(i) the Vijayaraghavachari Committee on Co-operation (1939-40):- Recommendation No.51. "The continuance of the guarantee by Government of the principal of and the interest on debentures of the Central Land Mortgage Bank is recommended":

(ii) The Seventh All-India Co-operative Conference held at Madras in May 1947 resolved as follows: Resolution No.14(i):- "This Conference is strongly of opinion that the guarantee of the principal of and interest on debentures of Co-operative Land Mortgage Banks by Provincial Government is as necessary as ever in order to make long-term credit available to agriculturists at reasonable rates of interest"

(iii) The Fifteenth Conference of the Registrars of Co-operative Societies held at Madras in May 1947 expressed themselves as follows in resolution 26(c) "Government should continue to guarantee the debentures of Land Mortgage Banks"

(iv) The Provincial Co-operative Conference held at Madras on the 12th and 13th of September 1947 under the Chairmanship of Hon'ble Minister for Local Administration resolved as follows:- Resolution No.9(a):- "The guarantee now given to the Central Land Mortgage Bank debentures must continue in the interests of agriculturists and Government should guarantee additional debentures that may be floated. The question of the withdrawal of the guarantee should be dropped".

4. AGRICULTURISTS WILL BE ADVERSELY AFFECTED: I strongly urge on Government that this question of withdrawing the Government guarantee from Central Land Mortgage Bank debentures should be dropped altogether as recommended by the recent Provincial Co-operative Conference, whose resolution has been cited above. My reasons for doing so are as follows:- Why is it that the proposal of withdrawing the guarantee is made at all? Is it because the guarantee now given has involved Government in any loss It is not so. Then, why is it made at all? I have taken some effort to find out this reason and the only reason that I can discover is stated in Government's letter No.519 dated 17-3-1941 addressed to the Reserve Bank of India in which it is said as follows:-"It is, and always has been the intention of the Government eventually to end the guarantee system" But this intention was the intention of an alien Government which was ruling the country at the time. They probably thought that they should not commit themselves to any financial responsibility which their successors in an indepdent India could not shoulder. Indeed, in paragraph 5 of the letter which I have cited, Government informed the Reserve Bank of India as follows:-"The Government under the present constitutional arrangements do not think that they are in a position to lay down a long-term policy in this matter with any definite prospect of its being followed by a popular ministry". Therefore, May I request that the present popular Ministry may look at the proposal not with reference to what their predecessors had intended but with reference to what the agricultural masses in this country need? Agriculturists need long-term money and need it at a cheap rate of interest. The Gadgil Committee on rural Indebtedness (1946) considered that long-term money should be made

available to agriculturists at 4% interest. Even with Government guarantee, the land mortgage Banks in this Province are able to lend to the agriculturists only at 6%, though recently the rate has been reduced to 5½% sacrificing a part of the margin of profits retained by the Central Land Mortgage Bank and the Primary Land Mortgage Banks If the Government withdraw their guarantee, the present patrons of these debentures (Insurance Companies, Co-operative Societies etc) will be lost (as we have already seen), and the general public who now constitute only 10% of the investors on debentures will purchase them only if they are made strikingly attractive. They may not look at them unless they are offered at 6%. This will enhance the interest charged on the agriculturist to 8 to 9% as against the 4% which the Gadgil Committee recommended, and then there will be an uproar from agriculturists.

5. EXAMPLE OF OTHER COUNTRIES: Uproar from agriculturists apart, the Governments of other democratic countries like the U.S.A., the Dominion of Canada and the Union of South Africa, have recognised it as their duty to assist agriculturists with cheap long-term money. Thus, the Farm Loans Administration of the U.S.A., is provided with funds by the U.S.A. Government for being lent to agriculturists. The Government of Canada is the sole share-holder of the Canadian Farm Loan Board. On 31-3-1944, it held 2,246,335 as shares and had also lent it $ 5,079,000 as advances. The Consolidated Land Bank Act of South Africa provides that the Parliament of the Union of South Africa may authorise the Minister of pay moneys to the Land and Agricultural Bank of South Africa as part of its funds. Even in Great Britain, the land of our former rulers, the State granted subsidies of which amounted to £.50,000/- in 1943-44, to the Agricultural Mortgage Corporation of London, and this enabled that corporation to lend at 4% on the loans issued by it even though it paid 4½% to 5% on the debentures money raised by it.

6. GOVERNMENT LOANS VERSES GOVERNMENT GUARANTEE: In the face of these examples, nobody will suggest that it is not the responsibility of Government to assist the agriculturist with long-term money at cheap rates of interest. The only question will be whether they should do so in shape of direct loans to the Central Land Mortgage Bank or whether they should do so guaranteeing its debentures. The former course will enhance the rate of interest to the agriculturists; for the Government, borrowing 3%, can lend to the Central Land Mortgage Bank only at 3½%, which means that the agriculturists can have loans only 5½% after allowing a margin of 2½% to the Primary Land Mortgage Bank and the Central Land Mortgage Bank. Moreover, the Government will have to borrow every year about ½ a crore to be lent to the Central Land Mortgage Bank which a more difficult operation than to guarantee the Central Land Mortgage Bank's debentures. Therefore, the best way in which the State can help the Central Land Mortgage Bank is to continue guaranteeing the debentures. The guarantee need not be called into question until and unless any danger arises and Government are called upon to make good their guarantee.

7. THE RESERVE BANK OF INDIA'S ADVICE NEED NOT BE HEEDED: In the memorandum under reply, Government have observed that even the Reserve Bank of India has consistently advocated the ending of the guarantee given by Government to the Central Land Mortgage Bank debentures. The first occasion when they raised the question was in their letter No.497/62-40, dated 28/8/1940 communicated with Government (Development) Endt.No.24048-V/40-2, dated 10-9-1940. Their reason for doing so was stated as follows: "We believe that from the very inception of the Land Mortgage Bank movement in Madras, the intention of the Madras Government was that the organisation should eventually stand financially on its own legs and that the guarantee, first of interest and then of both principal and interest, was given only as a start and that the guarantee system was to be abandoned once the banks had established themselves". I have indicated above that this original intention of the Government of Madras was the intention of an alien Government which is not supported by the policy adopted by democratic Governments in the Dominions & in Great Britain itself.

If Government withdraw their guarantee from the Central Land Mortgage Bank debentures, their financial help to the institution will be nil;

when most democratic countries have recognised that a banking institution cannot help agriculturists with cheap long-term money without financial assistance from Government. Therefore, the Reserve Bank of India's objection to guaranteeing the Land Mortgage Bank debenture on the ground that the original intention of the previous Government should be adhered to deserves no consideration.

8. Nor should any other argument advanced by the Reserve Bank of India for withdrawing the Government guarantee be given any weight for the following reasons: The attitude of that Bank towards the Central Land Mortgage Bank has always been influenced by its commercial outlook and its experience of Joint-stock banks. It has repeatedly endeavoured to apply to land mortgage banking the principles which govern the working of Joint-stock ~~sem~~ banks, ignoring the fact that land mortgage credit is a specialised form of credit. If the principles ~~vog~~ government joint-stock banking are to be followed in land mortgage banking, commercial banks should be doing this business and would not have fought shy of it. When they would not take up the business and when a separate system of land mortgage banking on a co-operative basis has been introduced by Government, the endeavour of the Reserve Bank of India to apply principles of joint-stock banking to co-operative land mortgage banks will only cripple them. My predecessor (Mr.Satthianadhan) had occasion to indicate this to Government pointedly in his D.O. letter No.6101/41-J, dated 27-5-1945, where he objected an officer of the Reserve Bank of India examining the financial condition of the Central Land Mortgage Bank and stated that "we shall be avoiding much controversial theory if we do not invite an officer of the Reserve Bank of India to inspect the Central Land Mortgage Bank". Government therefore directed the Central Land Mortgage Bank should be inspected jointly by the Registrar and the Examiner of Local Fund Accounts instead of by an officer of the Reserve Bank of India. This joint inspection resulting discarding the theory of the Reserve Bank that there ought to be separate sinking funds under the equated instalment system for every series of debentures. In their order No.2160, Development Department, dated 14/5/1947, Government directed instead that there ought to be only one Debenture Redemption Fund into which sufficient funds should be accumulated every year, under the fixed instalment system for repayment to debenture-holders. Even in the Fifteenth Conference of Registrars of Co-operative Societies, speaker after speaker hotly criticised the attitude of the Reserve Bank of India towards co-operative institutions. And if the Reserve Bank of India has changed its attitude in regard to lending on the security of Land Mortgage Bank debentures as indicated in paragraph 2(ii) above, it is due to this bitter criticism which was hurled on the representative of that bank who attended the Conference. I, therefore, submit that, on this question of the guarantee of the Central Land Mortgage Bank debentures, Government may reject the advice given by the Reserve Bank of India which has no experience of the practical working of land mortgage banking to go by except the experience derived from Madras where the movement has succeeded best in the whole of India.

9. CONCLUSION: In conclusion, I submit that, if Government do not accept the suggestion of the Provincial Conference which was held this month under the presidency of the Honible the Minister for Local Administration and Co-operation, viz. to drop the question of withdrawing their guarantee of the Central Land Mortgage Bank debentures, altogether, I recommend that the question need not be taken up until sub-clauses (a) and (d) of section 20 of the Indian Trusts Act are so amended as to make no reference to guaranties by a local Government. So long as there can be guarantee by a Local Government on behalf of a municipal body of a port-trust or other organisation which benefit urban folk there certainly can be a guarantee on behalf of the Central Land Mortgage Bank which benefits the rural masses.

Sd. J.C.RYAN,
Registrar.

/TRUE COPY/

GOVERNMENT OF MADRAS.
Abstract:

Co-Operative Societies - Land Mortgage Banks - Central Land Mortgage Bank - Guarantee of debentures by Govt. Continuance - Orders passed

Development Department.

G.O.Ms.No.5597. Dated 3rd December 1947

Read the following:--

Government Memo No.97849 B/46-1, dated 19-12-1946.
From the Registrar of Co-operative Societies, Letter No.Rc.20579/46-J, dated 28-9-1947.

ORDER:

The Government have carefully considered the question of the future policy to be adopted by them in regard to their guarantee of the debentures issued by the Madras Co-operative Central Land Mortgage Bank Limited and have decided that this guarantee should be continued for some more time.

2. The Registrar of Co-operative Societies is informed that he should exercise a very careful watch and control over the affairs of the Central Land Mortgage Bank at all times in order to avoid any possible risk of loss to the Government arising on account of their guarantee of such a large amount outstanding in debentures.

(BY ORDER OF THE GOVERNOR)

Sd. x x x x
Secretary to Government.

To
The Registrar of Co-operative Societies.
The Accountant-General, through Finance.
The Finance Department:
Copy to S.F. on L.M.Bs.

/TRUE COPY/

R. Thiagarajan 13.11.53

OFFICE ASSISTANT,
Madras Record Office.

RS/12/11

13/11/53 13.11

Finance (Exp.A) Deptt.

~~The notes of Development from page 2 above may be perused.~~

The Registrar of Co-operative Societies in his lett dated 28th September 1947 on pages 3-6 C.F. has made out a strong case for the retention of the Government guarantee for the repayment of the principal and interest in respect of the debentures issued by the C.L.M. Bank. The registrar has pointed out that if the Government guarantee is withdrawn with a view to make the debentures attractive to the general public, the Bank will have to offer an interest of as high as 6 per cent against the 4 per cent which the Gadgil Committee recommended. The argument that as much as 6 per cent interest will have to be offered seems somewhat exaggerated. It is, however, evident that if the guarantee is withdrawn, the Bank will have to offer at least 3½% to 4% which will also go to increase the rate to be charged to the agriculturists. As pointed out by the Registrar, the Government have not lost anything by standing guarantee for the repayment, of the principal and interest on the debentures issued by the C.L.M. Bank. The Bank is also working on sound lines, reserves are being built up, and proper amortisation provision made in respect of the debentures. The Government, through the Registrar, who is the trustee under Section 5 of the C.L.M. Bank Act, have effective control over the affairs of the Bank. This department may therefore also support the views of Development that the question of withdrawing the guarantee may be dropped at any rate for the present. H.M.(Fin) may see.

which will consequently enhance the interest to be charged to the agriculturists to 8 or 9 per cent

Sd. x x x
6-11-47

Hitherto the accepted policy has been to guarantee C€LM Bank debentures for the time being in the expectation that, when the Bank became well established and enjoyed the full confidence of the public, the necessity for the guarantee would cease to be exist. This view overlooked the fact that the debentures have been made "trustee securities" only by virtue of this Govt's guarantee and that if future issues ceased to be "trustee securities", the classes of investors who hold most of the existing issues would cease to be able to invest in future issues. In view of this, it appears that the R.C.S. is clearly right in maintaining that the guarantee should continue unless and until the Govt. of India are prepared to make the debentures "trustee securities" on their own merits without a Govt. guarantee, which they are very unlikely to agree to do. The R.C.S. will have to exercise a very careful watch and control over the affairs of the C.C.L.M. Bank at all times in order to avoid any possible risk of loss to the Govt. arising on account of their guarantee of such a large amount outstanding in debentures. H.M.(Fin) may see.

Sd. x x x
7-11-47.

Dev.108884 BIII

8-11-1947.

Development Department

TO A.S.

Notes from page 2 above may be perused. For the reasons summarised in paragraph 3 of the Deptt. notes at pp.5-7 above, the Registrar has proposed that the question of withdrawing the Govt. guarantee of the Central Land Mortgage Bank's debentures be dropped for the present. This Deptt. supported the Regr's proposal and the Finance Department have also agreed

agreed to it. The case may be submitted to H.M.(L.A), and H.M.(Fin) for orders whether the Registrar's proposal will be accepted and whether he may be informed as at "A" in the Finance Secretary's note on page 9 above.

The proposal of the R.C.S. may be accepted. As this is a very important subject covering the whole province and involving Govt. it is circulated to H.Pr. also.

MINUTES OF THE HON'BLE MINISTER(S). (Finance)

Our guarantee must continue for some more time.

Sd. x x x x
23-11-1947.

To Asst. Secretary:

A draft order is submitted for approval. H.M.(L.A.) may see ~~Hon~~ H.M.Fin's minute above.

To Asst. Secretary:

The file may be sent to Finance for persual of H.M.(FIN) minutes above, and the G.O. at page 7-8 c.f.

Sd. x x x x
4-12-1947.

Finance (Exp.A) Dept.

Seen. Thank..

Sd. x x x x
6-12-1947.

Development Department

This file may now be closed.

Sd. x x x x
9-12-47.

/TRUE COPY/

R. Thiagarajan
13-11-53

OFFICE ASSISTANT,
Madras Record Office.

13/11/53